



Outside Counsel

Expert Analysis

Are Insured's Legal Fees a Consequence Of 'Bi-Economy' and 'Panasia'?

In 2008, the New York Court of Appeals decided *Bi-Economy Market Inc. v. Harleysville Insurance Company of New York*¹ and *Panasia Estates Inc. v. Hudson Insurance Co.*²—decisions described by some as having “changed the landscape”³ for consequential damages claims asserted against insurance companies. Since then, complaints against first-party property damage insurers have commonly included demands for consequential damages, such as additional living expense and business income payments beyond policy limits.

Significantly, insureds are pointing to *Bi-Economy* and *Panasia* as a purported basis to demand another category of relief—the legal fees they incur in bringing their coverage lawsuits—even in the absence of any allegations of insurer bad faith. This article will examine the extent to which New York courts are permitting insureds to seek attorney's fees incurred in coverage suits under *Bi-Economy/Panasia*, and the likely result once the Court of Appeals ultimately revisits this issue.

'Bi-Economy'/'Panasia'

In *Bi-Economy*, the plaintiff insured's business premises sustained fire damage resulting in building structural damage and a loss of food inventory. Harleysville Insurance Company insured the plaintiff's building and contents, and covered business interruption (BI) losses for 12 months. Harleysville disputed the claimed BI loss amount and, after a year, had paid only seven months of plaintiff's BI claim.

The insured sued Harleysville, asserting claims for bad faith claim handling and breach of contract; it also sought consequential damages for the

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“complete demise of its business.”⁴ Harleysville moved for partial summary judgment to dismiss the breach of contract claim and to amend its answer to include a defense based on, among other things, the policy provision which excluded coverage for “consequential loss.” The Supreme Court, Monroe County, granted the motion, and the Appellate Division, Fourth Department, affirmed, but granted the insured's subsequent motion for leave to the Court of Appeals.

To what extent will New York courts permit insureds to seek attorney's fees incurred in coverage suits?

The Court of Appeals reversed and reinstated the insured's consequential damages claim resulting from Harleysville's alleged breach of its obligations under the policy. The Court noted that consequential damages—which do not flow directly from the breach—are also available, in addition to contract damages, where the parties reasonably contemplated them at the time of or prior to contracting. The Court determined that the insured had relied on Harleysville to make a good faith, timely investigation and payment for covered claims and that an insurer, aware of the purpose of BI coverage, would know that a breach of this obligation would subject it to damages for loss of the insured's business.

The Court also noted that when an insured “suffers additional damages as a result of an insurer's excessive delay or improper denial, the insurance company should stand liable for

these damages.”⁵ The Court thus held that “in light of the nature and purpose of the insurance at issue, as well as [the insured's] allegations that Harleysville breached its duty to act in good faith, we hold that Bi-Economy's claim for consequential damages including the demise of its business, was reasonably foreseeable and contemplated by the parties.”⁶ The claim, therefore, survived a motion for summary judgment. The insured did not assert a claim for attorney's fees and the Court did not otherwise address that issue.

In *Panasia*, the insured alleged that its insurer had failed to investigate or adjust its claim for several weeks and then denied the claim three months later. The insurer moved to dismiss “bad faith allegations and all prayers for consequential, extra-contractual, or incidental damages or attorneys [sic] fees.”⁷ The Appellate Division affirmed the trial court's denial of the motion to dismiss the consequential damages claims.

The Court of Appeals affirmed, citing *Bi-Economy*, noting that because the courts below failed to consider whether the insured's claimed damages were foreseeable as a result of the insurer's breach of its duty to “investigate, bargain for and settle claims in good faith,” that issue must be resolved below.⁸ The Court did not specifically address the insured's attorney's fees claim.

The American Rule

In American jurisprudence, when considering the award of attorney's fees, the “basic point of reference” is the “American Rule”—each litigant pays its own attorney's fees, win or lose, unless a statute or contract provides otherwise.⁹ New York follows the American rule and the Court of Appeals specifically confirmed, in the insurance context, that an insured cannot recover the amounts it expends in the successful prosecution of its rights against its insurance company.¹⁰ In *Mighty Midgets*

Inc. v. Centennial Ins. Co. the Court held that this practice “provid[es] freer and more equal access to the courts [and] promotes democratic and libertarian principles.”¹¹

Although *Mighty Midgets* carved out a narrow exception to the American rule by permitting an insured to recover its attorney’s fees when it “has been cast in a defensive posture by the legal steps an insurer takes in an effort to free itself from its policy obligations,”¹² it remains that New York precludes the recovery of legal fees by an insured in a coverage action against its carrier. It is against this backdrop that insureds’ counsel are now arguing that *Bi-Economy* and *Panasia* permit the insured to recover attorney’s fees as a consequential damage of the insurer’s failure to timely pay the insured’s first-party claim.

Since ‘Bi-Economy’/‘Panasia’

Some courts have affirmatively rejected insureds’ attempts to claim attorney’s fees as consequential damages. For example, in *Woodworth v. Erie Insurance Co.*,¹³ the insured sought leave to amend its complaint to assert a consequential damages claim for additional living expense and attorney’s fees arising from a fire loss. The Magistrate Judge recommended that the request to assert a claim for attorney’s fees be denied as futile. Specifically, the court held that:

Nothing in *Bi-Economy* or any post *Bi-Economy* authority cited by the parties suggests that the New York Court of Appeals intended through its *Bi-Economy* decision to alter in the insurance context the traditional American rule that each party should bear its own attorneys’ fees.¹⁴

Woodworth cited *Authel v. Nationwide Mutual Insurance Co.*,¹⁵ which granted that portion of the insurer’s summary judgment motion dismissing the insured’s claims for attorney’s fee and litigation expenses incurred by the insured to bring the coverage action. The court, citing *Mighty Midgets*, held that “to the extent that the plaintiff seeks consequential damages for ‘having been compelled to...retain legal counsel to seek redress,’” the insured was not entitled to recover legal fees or other legal expenses incurred to bring an action against an insurer to determine its rights under the policy.¹⁶ The court thus noted that “any consequential damages to which the plaintiff might ultimately be entitled shall be exclusive of such expenses.”¹⁷

Similarly, in *Handy & Harman v. American International Group Inc.*,¹⁸ while the court denied the insurer’s motion to dismiss the consequential/

extra-contractual damages claims based on *Bi-Economy/Panasia*, it specifically rejected and dismissed the insured’s claim for attorney’s fees to pursue the coverage action.

Other courts, however, suggest that *Bi-Economy/Panasia* might indicate a potential shift in the law in this regard. In *Chernish v. Massachusetts Mutual Life Insurance Co.*,¹⁹ the court denied the insurer’s motion to strike the insured’s request for attorney’s fees based upon cases which pre-dated *Bi-Economy* and *Panasia*. Noting that *Bi-Economy* has “changed the landscape,” the court determined that, on the insurer’s 12(b)(6) motion, the “pleading stage is too early in the litigation to resolve Plaintiff’s entitlement to attorney’s fees.”²⁰

In *Quick Response Commercial Division, LLC v. Travelers Property Casualty Company of America*, the court cited *Bi-Economy* and denied the insurer’s 12(b)(6) motion to dismiss the insured’s attorney’s fees claims holding that the insured “has adequately pled its claim for consequential damages to include past and accruing interest, and attorney’s fees and costs.”²¹

Conclusion

Courts should reject any suggestion that *Bi-Economy* or *Panasia* support an insured’s recovery of legal fees, even in the bad-faith context. Merely because those cases, in certain situations, permit the recovery of consequential damages does not mean that attorney’s fees are also recoverable. The American rule, followed by New York, generally precludes plaintiffs from recovering attorney’s fees—in breach of contract claims and otherwise—despite the fact that it is generally foreseeable that a party will have to incur legal fees to enforce its rights as a consequence of any breach. Nothing in *Bi-Economy* or *Panasia* suggests that there is logic in straying from this maxim in the first-party insurance context.

This issue has not yet been addressed by the Appellate Division or the U.S. Court of Appeals for the Second Circuit. Based on the increasing frequency of consequential damages claims asserted by first-party plaintiffs, it is inevitable that this issue will wind its way to the Court of Appeals. It is anticipated that the Court of Appeals will confirm that *Bi-Economy/Panasia* did not modify New York’s application of the American rule and that legal fees and expenses incurred by an insured bringing an affirmative insurance coverage action against its insurer are not recoverable, as a consequential damage or otherwise.

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1. 10 N.Y.3d 187, 886 N.E.2d 127, 856 N.Y.S.2d 505 (2008).
 2. 10 N.Y.3d 200, 886 N.E.2d 135, 856 N.Y.S.2d 513 (2008).
 3. *Chernish v. Massachusetts Mutual Life Ins. Co.*, No. 08 CV 0957 (GHL), 2009 U.S. Dist. Lexis 9617, 19 (Feb. 10, 2009).
 4. 10 N.Y.3d at 191, 886 N.E.2d at 129.
 5. *Id.* at 195, 886 N.E.2d at 132.
 6. *Id.* at 196, 886 N.E.2d at 132.
 7. 10 N.Y.3d at 202-03, 886 N.E.2d at 136.
 8. *Id.* at 203, 886 N.E.2d at 137.
 9. *Hardt v. Reliance Standard Life Ins. Co.*, 130 S. Ct. 2149, 2156-57 (2010).
 10. *Mighty Midgets Inc. v. Centennial Ins. Co.*, 47 N.Y.2d 12, 21-22, 389 N.E.2d 1080, 1085, 416 N.Y.S.2d 559, 564 (1979).
 11. *Id.* at 22, 389 N.E.2d at 1085, 416 N.Y.S.2d at 564. Some argue that rarely cited *Sukup v. State*, 19 N.Y.2d 519, 227 N.E.2d 842, 281 N.Y.S.2d 28 (1967), provides a second exception to New York’s application of the American rule in the insurance context. In *Sukup*, the Court of Appeals rejected the insured’s claim for legal fees and noted that although the insured prevailed in its quest for coverage, absent the insurer’s “gross disregard for its policy obligations” and a “showing of such bad faith in denying coverage that no reasonable carrier would, under the given facts, be expected to assert it,” so long as the insurer has an arguable basis for denying coverage, the insured is not entitled to attorney’s fees.
 12. *Mighty Midgets*, at 21, 389 N.E.2d at 1058, 416 N.Y.S.2d at 564.
 13. No. 05 CV 6344 (CJS), 2009 U.S. Dist. Lexis 49679 (WDNY June 12, 2009).
 14. *Id.* at 13.
 15. No. 03-15522, 2008 N.Y. Misc. Lexis 7527, 9 (Sup. Ct. Oct. 24, 2008).
 16. *Id.*
 17. *Id.*
 18. No. 115666/07, 2008 N.Y. Misc. Lexis 7522, 16-17 (Sup. Ct. Aug. 26, 2008).
 19. No. 08 CV 0957 (GHL), 2009 U.S. Dist. Lexis 9617 (Feb. 10, 2009).
 20. *Id.* at 21.
 21. No. 09 CV 651 (GLS/RFT), 2009 U.S. Dist. Lexis 95438, 5 (NDNY Oct. 14, 2009); see, e.g., *Whiteface Real Estate Dev. & Constr., LLC v. Selective Ins. Co. of Am.*, 08 CV 24 (GLS/DRH), 2010 U.S. Dist. Lexis 59741, 16-17 (NDNY June 16, 2010) (denying summary judgment motion seeking dismissal of consequential damages claim for attorney’s fees).

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